Financial Statements

2014 ANNUAL REPORT

Independent Electricity System Operator

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Message From Bruce Campbell and Tim O'Neill

The Independent Electricity System Operator (IESO) begins every year with goals and expectations for the ensuing 12 months. Given the ongoing transformation of the electricity sector, we know there will be change – both planned and unplanned. In addition to achieving the planned goals and objectives, an extra challenge came halfway through 2014 when it was announced that the IESO would be merging with the Ontario Power Authority (OPA). Employees of both organizations worked collaboratively with their new colleagues toward a smooth merger transition on January 1, 2015.

As Ontario's Reliability Coordinator, we also deal with changes affecting system operations – from unplanned generator outages to extreme weather events. In 2014, for example, the cool summer months resulted in lower than normal demand, which contributed to surplus baseload generation conditions, and Ontario saw a peak demand in the winter for the first time in 10 years. The year began with sustained cold weather that caused consistently high demand and increased reliance on natural gas generation. The IESO worked with its stakeholders to overcome these challenges and put plans in place to improve coordination between the electricity and gas sectors for the winter of 2015.

In addition to maintaining reliability, the IESO worked to strengthen Ontario's electricity system going forward. For instance, a joint report between the IESO and OPA, *Review of Ontario's Interties*, studied the value of the interties and identified potential areas to enhance them, including more frequent intertie scheduling and expanded provision of ancillary services. This was followed by a capacity exchange Memorandum of Understanding with Quebec that will provide each province with insurance during their complementary seasonal peaks. In addition, the IESO procured 34 megawatts of energy storage services that will support increased reliability and efficiency of the grid.

These achievements would not have been possible without the commitment of IESO employees, to whom we extend our thanks for their dedication.

Looking ahead, the IESO will continue to work with its stakeholders to explore market development opportunities identified in 2014, including the development of demand response and capacity auctions. Stakeholder input will be critical as we move forward to finalize the design elements for these initiatives.

Whatever 2015 holds, we are confident that the recently merged organization will inherit the resiliency of both former organizations.

Bruce Campbell
President and CEO
Independent Electricity System Operator

Tim O'Neill
Chairman of the Board
Independent Electricity System Operator

Year in Review

A look back at 2014 shows the ever-changing nature of Ontario's electricity system: coal-fired electricity was completely eliminated; new energy storage technologies came online while additional storage services were procured; the value of the interties was enhanced; and Ontario became a winter peaking province for the first time in 10 years.

The Independent Electricity System Operator (IESO), in partnership with its stakeholders, led a variety of initiatives in 2014 to make Ontario's electricity system more reliable, efficient and cost-effective.

Maintaining Reliability

Ontarians were welcomed into 2014 by extreme cold temperatures and biting wind chill, which ultimately became a long, harsh winter. For Ontario's electricity system, this resulted in consistently high demand and increased reliance on natural gas. Operators in the IESO's control room worked with neighbouring jurisdictions to mitigate any challenges and risks, ensuring the province's lights stayed on.

Record low temperatures in the early months of the year contrasted with unusually cool summer months, which offered different challenges for the IESO. In particular, this led to periods of low demand and, subsequently, surplus baseload generation conditions. Wind dispatch was critical during this time as it helped avoid shutting down nuclear units on 18 different occasions throughout the year. Overall, only one nuclear shutdown was required in 2014, down from six the previous year.

Sharing Information

The sustained cold weather of early 2014 was not without its lessons. Natural gas reserves were strained as they were consistently relied upon to meet both electricity and home heating needs. The heightened sensitivity to supply conditions throughout North America revealed some gaps in how the gas and electricity industries communicate. This contributed to a broader IESO initiative, the Gas-Electric Review.

Throughout 2014, IESO staff met with gas generators, utilities, pipeline operators and the Ontario Energy Board to discuss ways to improve cross-sector communication and coordination. The IESO now monitors publicly available gas industry information and is continuing to work with gas pipeline and storage providers to improve communication for operational and planning needs. Enhanced communication protocols now in place between the IESO, gas generators and pipelines proved very beneficial this past winter.

The IESO made its own effort to improve communication with its stakeholders and the general public by launching a revamped website in February. The enhanced, interactive website enables Ontarians to learn more about how the power system and electricity markets work and to retrieve data on real-time electricity supply, demand and price. Easily accessible market data will become increasingly important as Ontario's electricity system continues to evolve. The website serves to demonstrate the IESO's commitment to transparency in system and market operations.

Integrating New Resources

Over 2014, the IESO integrated more than 1,900 megawatts of wind, solar, biofuel and hydro generation into the province's transmission and distribution systems. Increasing renewable generation contrasted with declining coal-fired generation and, in April, the Thunder Bay Generating Station burned its last supply of coal, marking the end of coal-fired electricity in Ontario.

New technologies also began contributing to the grid as storage facilities from NRStor and Renewable Energy Systems Canada (RES) became operational, the outcome of a 2012 procurement of regulation services. NRStor's two-megawatt flywheel and RES Canada's four-megawatt battery act to help match total generation on the system with total demand on a second-by-second basis. The two projects represent a major step forward by increasing the participation of alternative technologies in providing regulation service, a function traditionally provided by generators.

Supporting Innovation

The IESO issued a Request for Proposals in March to procure up to 35 megawatts of energy storage to explore how new technologies can provide flexibility in grid operations. The competitive procurement sought solutions capable of providing ancillary services—specifically, regulation or reactive support and voltage control services—and demonstrated the IESO's support for Ontario's burgeoning energy storage industry.

Five companies were selected representing a diverse range of technologies, including battery, thermal, hydrogen storage and flywheel. These successful applicants will build 12 projects across Ontario, providing valuable learnings about the future potential of energy storage in Ontario. Upon their commercial operation, these projects will support increased reliability and efficiency of the grid.

Market Development Initiatives

In addition to integrating new generation and procuring energy storage services, the IESO pursued opportunities to make Ontario's electricity market more competitive and efficient. Working with its stakeholders, the IESO introduced new market development initiatives to examine the potential benefits and design structure of auctions for capacity and demand response.

The province's Long-Term Energy Plan expects demand response to meet 10 percent of peak demand by 2025 under forecast conditions. Demand response auctions will provide a venue in which participants can compete and are expected to result in the most cost-effective solutions for Ontario's ratepayers. Capacity auctions are expected to achieve similar outcomes and are intended to meet Ontario's incremental capacity needs that are projected for the years ahead. The IESO will continue to work with stakeholders to bring these initiatives to the market.

Enhancing the Value of the Interties

Electricity imports and exports are part of the regular operation of Ontario's electricity market. In October, the IESO released a joint report with the Ontario Power Authority to study the value of Ontario's interties and examine opportunities to expand electricity imports. The report, entitled *Review of Ontario's Interties*, found that increased reliance on interties through firm imports would require investments in transmission infrastructure but that there are opportunities to enhance the benefits of existing interties.

Possible enhancements include more frequent intertie scheduling and expanded provision of ancillary services, such as operating reserve, through intertie transactions. These changes hold promise to make Ontario's operations more efficient. The IESO will work with stakeholders to consider these opportunities throughout 2015.

On November 21, shortly after the release of the interties report, the IESO signed a Memorandum of Understanding with Hydro-Quebec to enhance the use of the interties through a capacity exchange between Ontario and Quebec. This exchange will support the reliability of each province's electricity systems by taking advantage of their complementary seasonal peaks of electricity resources and needs. Discussions are ongoing and an agreement is expected by June.

Building on Our Accomplishments

As 2014 came to a close, the IESO prepared to merge with the Ontario Power Authority and, on January 1, 2015, these two organizations amalgamated. As a merged organization, the IESO has a more well-rounded and complete set of responsibilities. The scope of its operations ranges from planning 20 years ahead to operating the grid second-by-second. The result will be a more effective integration of the planning outlook with operational experience, with those insights being brought into procurement planning. IESO merger-related expenses in 2014 were $5.3 million.

Moving forward, the new organization will build on the developments of 2014 and continue to provide public value for Ontario's ratepayers. Maintaining the reliability of the grid will continue to be a priority, as will pursuing opportunities to bend the cost curve for consumers. The IESO looks forward to working alongside its stakeholders on behalf of Ontario's ratepayers in 2015 and the years to come.

Board of Directors

Tim O'Neill
Chairman of the Board
Retired from BMO Financial Group, where he served as Executive Vice-President and Chief Economist; President of O'Neill Strategic Economics

William Museler
Chair, Audit Committee
Former President and Chief Executive Officer of the New York Independent System Operator

Tricia O'Malley
Former Chair of the Canadian Accounting Standards Board and the Ontario Securities Commission's Financial Disclosure Advisory Board

Angela Ferrante
Former Chief Operating Officer of the Ontario Energy Board; former Vice-President, Public Affairs at Ontario Power Generation

Murray Elston
Former Chair of the Electricity Distribution Panel; former President of the Canadian Nuclear Association; former Ontario Minister of Health

David Cassivi
Former Chair of ENWIN Utilities; former Windsor City Councillor

Helen Polatajko
Former Senior Vice-President and Chief Information Officer at CIBC Mellon

Margaret Kelch
Chair of the Conservation Committee, Nature Conservancy of Canada; former board member of the Electrical Safety Authority and Guelph Hydro Electric Systems Inc.

Rudy Riedl
Vice Chair, Chair, Human Resources and Governance Committee
Former President, Enbridge Consumers Gas

John Wiersma
Retired from Veridian Corporation, where he served as President and Chief Executive Officer, and Chair of the Board of Directors

Bruce Campbell
President and Chief Executive Officer, Independent Electricity System Operator

Executive Leadership Team

Tim O'Neill
Chairman of the Board

Bruce Campbell
President and Chief Executive Officer

Doug Thomas
Vice-President, Information and Technology Services and Chief Information Officer

Kim Warren
Vice-President, Operations and Chief Operating Officer

Terry Young
Vice-President, Corporate and Employee Relations

Ted Leonard
Vice-President, Markets, Chief Financial Officer and Treasurer

John Rattray
General Counsel, Secretary and Chief Reliability Compliance Officer

A Special Thanks to the Stakeholder Advisory Committee

The Stakeholder Advisory Committee (SAC) was established to advise the IESO's Board of Directors and management on policy issues related to the IESO's mandate. SAC membership is broadly reflective of stakeholder constituencies with a direct interest in IESO decisions.

The Stakeholder Advisory Committee was comprised of 14 people with significant expertise in Ontario's electricity sector:

Todd Wilcox
Chair, Stakeholder Advisory Committee
Chief Operating Officer, North Bay Hydro

Jack Burkom
Senior Vice-President, Commercial Development, Brookfield Energy Marketing

David Butters
President and Chief Executive Officer, Association of Power Producers of Ontario

Michelle Chislett
Managing Director, Business Development, SunEdison

Paul Ferguson
President, Newmarket-Tay Power Distribution Ltd.

Ted Leonard
Vice-President, Markets, Chief Financial Officer and Treasurer, IESO

Steven Hall
Consumer Representative, Stakeholder Advisory Committee

Richard Horrobin
Vice-President, Power Marketing and Chief Information Officer, Bruce Power

Tony Thoma
Dean, Engineering Technology and Media Studies, Mohawk College

Mark Schembri
Vice-President, Supermarket Systems & Store Maintenance, Loblaw Properties Ltd.

Ersilia Serafini
Chief Executive Officer, Summerhill

Paul Shervill
Vice-President, Strategic Initiatives, Rodan Energy Solutions

Adam White
President, Association of Major Power Consumers of Ontario

Wayne Smith
Senior Vice-President, Planning and Operations, Hydro One

Management Report

Management's Responsibility for Financial Reporting

The accompanying financial statements of the Independent Electricity System Operator are the responsibility of management and have been prepared in accordance with Canadian public sector accounting standards. The significant accounting policies followed by the Independent Electricity System Operator are described in the Summary of Significant Accounting Policies contained in Note 2 in the financial statements. The preparation of financial statements necessarily involves the use of estimates based on management's judgment, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been prepared within reasonable limits of materiality and in light of information available up to February 18, 2015.

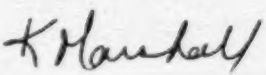
Management maintained a system of internal controls designed to provide reasonable assurance that the assets were safeguarded and that reliable information was available on a timely basis. The system included formal policies and procedures and an organizational structure that provided for the appropriate delegation of authority and segregation of responsibilities.

These financial statements have been examined by KPMG LLP, a firm of independent external auditors appointed by the Board of Directors. The external auditors' responsibility is to express their opinion on whether the financial statements are fairly presented in accordance with generally accepted accounting principles in Canada. The Auditors' Report, which follows, outlines the scope of their examination and their opinion.

INDEPENDENT ELECTRICITY SYSTEM OPERATOR

On behalf of management,

Bruce Campbell
President, Chief Executive Officer
Toronto, Canada
February 18, 2015



Kimberly Marshall
Vice-President, Corporate Services and
Chief Financial Officer
Toronto, Canada
February 18, 2015

Independent Auditors' Report

To the Board of Directors of the Independent Electricity System Operator (IESO)

We have audited the accompanying financial statements of IESO, which comprise the statement of financial position as at December 31, 2014, the statements of operations and accumulated deficit, remeasurement gains and losses, change in net debt and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian public sector accounting standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of IESO as at December 31, 2014, and its results of operations and the changes in its net debt and its cash flows for the year then ended in accordance with Canadian public sector accounting standards.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants
February 18, 2015
Waterloo, Canada

Statement of Financial Position

As at (in thousands of Canadian dollars)	December 31, 2014	December 31, 2013
	$	$
FINANCIAL ASSETS		
Cash and cash equivalents	11,886	9,569
Accounts receivable	17,813	17,592
Long-term investments **(Note 3)**	33,979	31,801
TOTAL FINANCIAL ASSETS	**63,678**	**58,962**
LIABILITIES		
Accounts payable and accrued liabilities **(Note 4)**	25,862	24,178
Accrued interest on debt	364	266
Rebates due to market participants **(Note 5)**	–	25,755
Debt **(Note 6)**	129,000	124,200
Accrued pension liability **(Note 7)**	36,943	35,139
Accrued liability for employee future benefits other than pension **(Note 7)**	79,914	74,069
TOTAL LIABILITIES	**272,083**	**283,607**
NET DEBT	**(208,405)**	**(224,645)**
NON-FINANCIAL ASSETS		
Net tangible capital assets **(Note 8)**	95,051	91,636
Prepaid expenses	5,468	4,455
TOTAL NON-FINANCIAL ASSETS	**100,519**	**96,091**
ACCUMULATED DEFICIT		
Accumulated deficit from operations **(Note 5)**	(114,248)	(132,698)
Accumulated remeasurement gains	6,362	4,144
ACCUMULATED DEFICIT	**(107,886)**	**(128,554)**

On behalf of the Board:

Jim Hinds
Chair
Toronto, Canada

Ron Jamieson
Director
Toronto, Canada

Statement of Operations and Accumulated Deficit

For the year ended December 31 (in thousands of Canadian dollars)	2014 Budget $	2014 Actual $	2013 Actual $
WHOLESALE MARKET OPERATIONS			
System fees	126,576	129,548	115,683
Other revenue **(Note 9)**	3,291	3,583	3,143
Interest and investment income	1,012	2,798	1,601
Wholesale market operation revenues	**130,879**	**135,929**	**120,427**
Wholesale market operation expenses **(Note 10)**	(127,601)	(128,364)	(118,422)
IESO-OPA amalgamation expenses **(Note 10)**	–	(5,305)	–
Wholesale market operations annual surplus	**3,278**	**2,260**	**2,005**
MARKET SANCTIONS AND PAYMENT ADJUSTMENTS			
Market sanctions and payment adjustments	–	2,687	3,191
Customer education and market enforcement expenses **(Note 10)**	(4,083)	(4,363)	(3,856)
Market sanctions and payment adjustments annual deficit	**(4,083)**	**(1,676)**	**(665)**
SMART METERING ENTITY			
Smart metering charge	45,207	45,735	30,144
Smart metering expenses **(Note 10)**	(33,327)	(27,869)	(26,531)
Smart metering entity annual surplus	**11,880**	**17,866**	**3,613**
ANNUAL SURPLUS	**11,075**	**18,450**	**4,953**
ACCUMULATED DEFICIT FROM OPERATIONS, BEGINNING OF PERIOD	(132,698)	(132,698)	(137,651)
ACCUMULATED DEFICIT FROM OPERATIONS, END OF PERIOD	**(121,623)**	**(114,248)**	**(132,698)**

Statement of Remeasurement Gains and Losses

For the year ended December 31 (in thousands of Canadian dollars)	2014 Actual $	2013 Actual $
ACCUMULATED REMEASUREMENT GAINS, BEGINNING OF PERIOD	**4,144**	**1,547**
UNREALIZED GAINS ATTRIBUTABLE TO:		
Foreign exchange – other	591	178
Portfolio investments **(Note 3)**	2,622	2,454
AMOUNTS RECLASSIFIED TO THE STATEMENT OF OPERATIONS:		
Foreign exchange – other	(178)	(35)
Portfolio investments	(817)	–
NET REMEASUREMENT GAINS FOR THE PERIOD	**2,218**	**2,597**
ACCUMULATED REMEASUREMENT GAINS, END OF PERIOD	**6,362**	**4,144**

Statement of Change in Net Debt

For the year ended December 31 (in thousands of Canadian dollars)	2014 Budget $	2014 Actual $	2013 Actual $
ANNUAL SURPLUS	**11,075**	**18,450**	**4,953**
CHANGE IN NON-FINANCIAL ASSETS			
Acquisition of tangible capital assets	(23,955)	(22,930)	(22,196)
Amortization of tangible capital assets	21,558	19,515	18,167
Change in prepaid expenses	948	(1,013)	(767)
TOTAL CHANGE IN NON-FINANCIAL ASSETS	**(1,449)**	**(4,428)**	**(4,796)**
NET REMEASUREMENT GAINS FOR THE PERIOD	972	2,218	2,597
CHANGE IN NET DEBT	**10,598**	**16,240**	**2,754**
NET DEBT, BEGINNING OF PERIOD	(224,645)	(224,645)	(227,399)
NET DEBT, END OF PERIOD	**(214,047)**	**(208,405)**	**(224,645)**

Statement of Cash Flows

For the year ended December 31 (in thousands of Canadian dollars)	2014	2013
	$	$
OPERATING TRANSACTIONS		
Annual Surplus	**18,450**	**4,953**
Changes in non-cash items:		
Amortization	19,515	18,167
Pension expense	13,777	10,800
Other employee future benefits expense	8,166	6,907
Change in fair value of long-term investments	(1,100)	–
	40,358	35,874
Changes in non-cash balances related to operations:		
Change in accounts payable and accrued liabilities	1,934	(2,146)
Change in accounts receivable	(221)	(759)
Change in rebates due to market participants	(25,755)	12,648
Change in prepaid expenses	(1,013)	(767)
	(25,055)	8,976
Other:		
Contribution to pension fund	(11,973)	(17,261)
Payment of employee future benefits	(2,321)	(2,093)
	(14,294)	(19,354)
Cash provided by operating transactions	**19,459**	**30,449**
CAPITAL TRANSACTIONS		
Acquisition of tangible capital assets	(22,930)	(22,196)
Change in accounts payable & accrued liabilities	(152)	4,936
Cash applied to capital transactions	**(23,082)**	**(17,260)**
INVESTING TRANSACTIONS		
Change provided by/(applied to) long-term investments	727	(1,626)
Cash provided by/(applied to) investing transactions	**727**	**(1,626)**
FINANCING TRANSACTIONS		
Change in debt	4,800	(9,000)
Cash provided by/(applied to) financing transactions	**4,800**	**(9,000)**
INCREASE IN CASH AND CASH EQUIVALENTS	1,904	2,563
CASH AND CASH EQUIVALENTS – BEGINNING OF PERIOD	9,569	6,863
Change in unrealized foreign exchange – other for the period	413	143
CASH AND CASH EQUIVALENTS – END OF PERIOD	**11,886**	**9,569**

Notes to Financial Statements

1. NATURE OF OPERATIONS

a) Independent Electricity System Operator (IESO) is a not-for-profit, non-taxable corporation, created by statute effective on April 1, 1999 pursuant to Part II of the *Electricity Act, 1998*. As set out in the *Electricity Act, 1998*, the IESO operates pursuant to a licence granted by the Ontario Energy Board (OEB). The objects of the IESO as contained in the *Electricity Act, 1998* and amended, in the *Electricity Restructuring Act, 2004* and Ontario Regulation 452/06, are as follows:

- to exercise the powers and perform the duties assigned to the IESO under the *Electricity Restructuring Act, 2004*, the market rules and its licence;
- to enter into agreements with transmitters giving the IESO the authority to direct the operation of their transmission systems;
- to direct the operation and maintain the reliability of the IESO-controlled grid to promote the purposes of the *Electricity Restructuring Act, 2004*;
- to participate in the development, by any standards authority, of standards and criteria relating to the reliability of the transmission systems;
- to work with the responsible authorities outside Ontario to co-ordinate the IESO's activities with their activities;
- to collect and provide information to the Ontario Power Authority (OPA) and the public relating to the current and short-term electricity needs of Ontario and the adequacy and reliability of the integrated power system to meet those needs;
- to operate the IESO-administered markets to promote the purposes of the *Electricity Restructuring Act, 2004*;
- to plan, manage and implement the smart metering initiative or any aspect of the initiative;
- to oversee, administer and deliver the smart metering initiative or any aspect of the initiative; and
- to establish and enforce standards and criteria relating to the reliability of transmission systems.

b) The IESO was designated the Smart Metering Entity by Ontario Regulation 393/07 under the *Electricity Act, 1998* on March 28, 2007. The regulation came into effect on July 26, 2007.

The objects of the Smart Metering Entity (SME), as contained in the *Electricity Act, 1998*, are as follows:

- to plan and implement and, on an ongoing basis, oversee, administer and deliver any part of the smart metering initiative as required by regulation under this or any Act or directive made pursuant to sections 28.3 or 28.4 of the *Ontario Energy Board Act, 1998*, and, if so authorized, to have the exclusive authority to conduct these activities;
- to collect and manage and to facilitate the collection and management of information and data and to store the information and data related to the metering of consumers' consumption or use of electricity in Ontario, including data collected from distributors and, if so authorized, to have the exclusive authority to collect, manage and store the data;
- to establish, to own or lease and to operate one or more databases to facilitate collecting, managing, storing and retrieving smart metering data;

- to provide and promote non-discriminatory access, on appropriate terms and subject to any conditions in its licence relating to the protection of privacy, by distributors, retailers, the OPA and other persons,
  i. to the information and data referred to above, and
  ii. to the telecommunication system that permits the Smart Metering Entity to transfer data about the consumption or use of electricity to and from its databases, including access to its telecommunication equipment, systems and technology and associated equipment, systems and technologies
- to own or to lease and to operate equipment, systems and technology, including telecommunication equipment, systems and technology that permit the Smart Metering Entity to transfer data about the consumption or use of electricity to and from its databases, including owning, leasing or operating such equipment, systems and technology and associated equipment, systems and technologies, directly or indirectly, including through one or more subsidiaries, if the Smart Metering Entity is a corporation;
- to engage in such competitive procurement activities as are necessary to fulfill its objects or business activities;
- to procure, as and when necessary, meters, metering equipment, systems and technology and any associated equipment, systems and technologies on behalf of distributors, as an agent or otherwise, directly or indirectly, including through one or more subsidiaries, if the Smart Metering Entity is a corporation;
- to recover, through just and reasonable rates, the costs and an appropriate return approved by the Ontario Energy Board associated with the conduct of its activities; and
- to undertake any other objects that are prescribed by associated regulation.

c) The IESO is required to submit its proposed expenditures, revenue requirements, and fees for the coming year to the OEB for review and approval. The submission may be made only with the approval or deemed approval of the IESO business plan by the Minister of Energy (Minister).

d) Bill 14, *Building Opportunity and Securing Our Future Act (Budget Measures), 2014* received Royal Assent on July 24, 2014. Schedule 7 of the Bill amends the *Electricity Act, 1998* by amalgamating the IESO and the Ontario Power Authority ("OPA") and by continuing them as the IESO. The transitional provision, dealing with corporate matters, provides, among other things, that the predecessor IESO and OPA cease to exist as entities separate from the IESO and all their rights, properties and assets become the rights, properties and assets of the IESO, as do all outstanding debts, liabilities and obligations of the predecessor IESO and OPA. Schedule 7 of Bill 14 came into force on January 1, 2015.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Basis of financial statement preparation

The accompanying financial statements have been prepared on a going concern basis and in accordance with Canadian public sector accounting standards and reflect the following significant accounting policies:

b) Revenue recognition

System fees earned by the IESO are based on approved rates for each megawatt of electricity withdrawn from the IESO-controlled grid (including scheduled exports) and embedded generation. System fees are recognized as revenue at the time the electricity is withdrawn. Rebates are recognized in the year in which the approved regulatory deferral account, before such rebates, exceeds regulated limits.

These financial statements do not include the financial transactions of market participants within the IESO-administered markets.

Other revenue represents amounts that accrue to the IESO relating to services the IESO performs and charges on a cost recovery basis, investment income on funds passing through market settlement accounts, as well as application fees. Such revenue is recognized as is earned.

Interest and investment income represents realized interest income and investment gains or losses on cash, cash equivalents, short-term investments and long-term investments.

Market sanctions represent funds received and payments disbursed related to penalties, damages, fines and payment adjustments arising from resolved settlement disputes.

c) Financial instruments

The IESO records cash and cash equivalents, investment portfolio, and foreign currency exchange forward contracts at fair value. The cumulative change in fair value of these financial instruments is recorded in accumulated surplus as remeasurement gains and losses and is included in the value of the respective financial instrument shown in the statement of financial position and the statement of remeasurement gains and losses. Upon disposition of the financial instruments, the cumulative remeasurement gains and losses are reclassified to the statement of operations and all other gains and losses associated with the disposition of the financial instrument are recorded in the statement of operations. Transaction costs are charged to operations as incurred.

Cash and cash equivalents comprise cash, term deposits and other short-term, highly-rated investments with original maturity dates of less than 90 days.

The IESO records accounts receivable, accounts payable and debt at amortized cost.

d) Tangible capital assets

Tangible capital assets are recorded at cost which includes all amounts directly attributable to the acquisition, construction, development or betterment of the asset. The IESO capitalizes applicable interest as part of the cost of tangible capital assets.

e) Assets under construction

Assets under construction generally relates to the costs of physical facilities, hardware and software, and includes costs paid to vendors, internal and external labour, consultants and interest related to funds borrowed to finance the project. Costs relating to assets under construction are transferred to tangible capital assets when the asset under construction is deemed to be ready for use.

f) Amortization

The capital cost of tangible capital assets in service is amortized on a straight-line basis over their estimated service lives.

The estimated service lives in years, from the date the assets were acquired, are:

Class	Estimated Average Service Life 2014	Estimated Average Service Life 2013
Facilities	38	38
Market systems and applications	4 to 12	4 to 10
Infrastructure and other assets	4 to 8	4 to 7
Meter data management/repository	10	10

Gains and losses on sales or premature retirements of tangible capital assets are charged to operations.

The estimated service lives of tangible capital assets are subject to periodic review. The effects of changes in the estimated lives are amortized on a prospective basis. The most recent review was completed in fiscal 2014.

g) Pension, other post-employment benefits and compensated absences

The IESO's post-employment benefit programs include pension, group life insurance, health care, long-term disability and workers compensation benefits.

The IESO accrues obligations under pension and other post-employment benefit (OPEB) plans and the related costs, net of plan assets. Pension and OPEB expenses and obligations are determined annually by independent actuaries using the projected benefit method and management's best estimate of expected return on plan assets, salary escalation, retirement ages of employees, mortality and expected health-care costs. The discount rate used to value liabilities is based on the expected rate of return on plan assets as at the measurement date of September 30.

The expected return on plan assets is based on management's long-term best estimate using a market-related value of plan assets. The market-related value of plan assets is determined using the average value of assets over three years as at the measurement date of September 30.

Pension and OPEB expenses are recorded during the year in which employees render services. Pension and OPEB expenses consist of current service costs, interest expense on liabilities, expected return on plan assets and the cost of plan amendments in the period. Actuarial gains/(losses) arise from, among other things, the difference between the actual rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period or from changes in actuarial assumptions used to determine the accrued benefit obligations. Actuarial gains/(losses) are amortized over the expected average remaining service life of the employees covered by the plan.

The expected average remaining service life of employees covered by the pension plans is 13 years (2013 – 13 years) and OPEB plans is 14 years (2013 – 14 years).

The IESO sick pay benefits accumulate but do not vest. The IESO accrues sick pay benefits based on the expectation of future utilization, and records the accrual within accounts payable and accrued liabilities.

h) Foreign currency exchange

Transactions denominated in foreign currencies are translated into Canadian dollars at the rate of exchange prevailing on the date of the transaction. Items on the statement of financial position denominated in foreign currency are translated to Canadian dollars at the rate of exchange as of the financial statements date. The cumulative unrealized foreign currency exchange gains and losses of items continuing to be recognized on the statement of financial position are recorded in accumulated deficit as remeasurement gains and losses and shown in the statement of financial position and the statement of remeasurement gains and losses. Upon settlement of the item denominated in a foreign currency, the cumulative remeasurement gains and losses are reclassified to the statement of operations and all other gains and losses associated with the disposition of the financial instrument are recorded in the statement of operations.

i) Use of estimates

The preparation of the financial statements in conformity with Canadian public sector accounting standards requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities and the disclosure of contingent assets and liabilities as at the date of the financial statements. The IESO's accounts which involve a greater degree of uncertainty include the carrying values of tangible capital assets, rebates to market participants, accrued pension liability, and accrual for employee future benefits other than pensions. Actual results could differ from those estimates.

3. LONG-TERM INVESTMENTS

Long-term investments in a balanced portfolio of pooled funds are valued by the pooled funds manager based on published price quotations and amount to $33,758 thousand (2013 – $31,683 thousand). As at December 31, the market value allocation of these long-term investments was 59.7% equity securities and 40.3% debt securities (2013 – 65.0% and 35.0% respectively).

Balanced portfolio of pooled funds

As at December 31 (in thousands of Canadian dollars)	2014	2013
	$	$
Opening balance	31,683	27,721
Purchase/(sale) of investments	(830)	1,508
Change in fair value	2,905	2,454
Closing balance	**33,758**	**31,683**

In addition to the balanced portfolio of pooled funds, the IESO has a long-term deposit with Canada Revenue Agency in the amount of $221 thousand (2013 – $118 thousand) pertaining to the Retirement Compensation Arrangements Trust (Note 6).

4. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

As at December 31 (in thousands of Canadian dollars)	2014	2013
	$	$
Relating to operations	18,856	17,020
Relating to tangible capital assets	7,006	7,158
	25,862	**24,178**

5. REBATES DUE TO MARKET PARTICIPANTS AND ACCUMULATED DEFICIT

In 2014, the IESO recognized $nil thousand in rebates due to market participants of system fees (2013 – $12,648 thousand). As at December 31, 2014 rebates due to market participants were $nil thousand (2013 – $25,755 thousand).

Historically, the IESO's approved regulatory deferral account balance is maintained at a maximum of $5.0 million. The 2014 approved regulatory deferral account balance will be established at the time of the 2015 rate case with the OEB, which is expected to be in the spring of 2015.

As at December 31, the components of the accumulated deficit were as follows:

Accumulated Deficit

As at December 31 (in thousands of Canadian dollars)	2014	2013
	$	$
Regulatory deferral account (a)	5,228	5,000
Accumulated market sanctions and payment adjustments (b)	(970)	706
Smart metering entity – accumulated deficit (c)	(60,879)	(78,745)
PSAB transition items (d)	(51,265)	(55,515)
Accumulated deficit – end of year	**(107,886)**	**(128,554)**

a) Approved Regulatory Deferral Account

As at December 31 (in thousands of Canadian dollars)	2014	2013
	$	$
Accumulated surplus – beginning of year	5,000	5,000
Revenues (before rebates due to market participants)	135,929	133,075
Rebates due to market participants	–	(12,648)
Wholesale market operation expenses	(128,364)	(118,422)
IESO – OPA amalgamation expenses	(5,305)	–
Change in accumulated remeasurement gains	2,218	2,597
Recovery of PSAB transition items	(4,250)	(4,602)
Accumulated surplus – end of year	**5,228**	**5,000**

b) Accumulated Market Sanctions and Payment Adjustments

As at December 31 (in thousands of Canadian dollars)	2014	2013
	$	$
Accumulated surplus – beginning of year	706	1,371
Market sanctions and payment adjustments	2,687	3,191
Customer education and market enforcement expenses	(4,363)	(3,856)
Accumulated surplus/(deficit) – end of year	**(970)**	**706**

c) Smart Metering Entity – Accumulated Deficit

As at December 31 (in thousands of Canadian dollars)	2014	2013
	$	$
Accumulated deficit – beginning of year	(78,745)	(82,358)
Smart metering charge	45,735	30,144
Smart metering expenses	(27,869)	(26,531)
Accumulated deficit – end of year	**(60,879)**	**(78,745)**

d) PSAB Transition Item – Accumulated Deficit

As at December 31 (in thousands of Canadian dollars)	2014	2013
	$	$
Accumulated deficit – beginning of year	(55,515)	(60,117)
Recovery of PSAB transition items	4,250	4,602
Accumulated deficit – end of year	**(51,265)**	**(55,515)**

Effective January 1, 2011, the IESO adopted Canadian public sector accounting standards (PSAB) with a transition date of January 1, 2010. The adoption of PSAB was accounted for by retroactive application with restatement of prior periods subject to the requirements in Section PS 2125, *First-time Adoption by Government Organizations*. The corresponding change to pension and other-post employment benefits resulted in previously unrecognized actuarial losses and past service costs of $80,617 thousand at the date of transition being charged to the accumulated deficit.

The IESO includes a portion of the accumulated deficit resulting from the PSAB transition items in the annual proposed expenditures to the OEB for recovery through system fees.

6. DEBT

Note payable to Ontario Electricity Financial Corporation (OEFC)

In April 2014, the IESO entered into a three-year note payable with the OEFC. The note payable is unsecured, bears interest at a fixed rate of 2.046% per annum and is repayable in full on April 30, 2017. Interest accrues daily and is payable in arrears semi-annually in April and October of each year. As at December 31, 2014, the note payable to the OEFC was $90.0 million (December 31, 2013 – $78.2 million).

For the year ended December 31, 2014, the interest expense on the note payable was $1,650 thousand (2013 – $1,430 thousand).

Credit facility

The IESO has an unsecured credit facility agreement with the OEFC, which will make available to the IESO an amount up to $95.0 million. Advances are payable at a variable interest rate equal to the Province of Ontario's cost of borrowing for a 30 day term plus 0.50% per annum, with draws, repayments and interest payments due monthly. The credit facility expires April 30, 2017. As at December 31, 2014, $39.0 million was drawn on the credit facility (December 31, 2013 – $46.0 million).

For the year ended December 31, 2014, the interest expense on the credit facility was $664 thousand (2013 – $790 thousand).

Retirement Compensation Arrangements Trust

In July 2013, the IESO established a Retirement Compensation Arrangements Trust (RCA) to provide security for the IESO's obligations under the terms of the supplemental employee retirement plan for its employees. As at December 31, 2014, the IESO has provided the RCA trustee with a bank letter of credit of $23,370 thousand (2013 – $26,831 thousand) the trustee can draw on if the IESO is in default under the terms of this plan.

7. POST-EMPLOYMENT BENEFIT PLANS

The IESO provides pension and other employee post-employment benefits, comprising group life insurance, long-term disability and group medical and dental plans, for the benefit of current and retired employees.

Pension plans

The IESO provides a contributory defined benefit, indexed, registered pension plan. In addition to the funded, registered, pension plan, the IESO provides certain non-registered defined benefit pensions through an unfunded, indexed, non-registered plan.

Other employee future benefits

The group life insurance, long-term disability and group medical and dental benefits are provided through unfunded, non-registered defined benefit plans.

Summary of accrued benefit obligations and plan assets

(in thousands of Canadian dollars)	2014 Pension Benefits	2013 Pension Benefits	2014 Other Benefits	2013 Other Benefits
	$	$	$	$
Accrued benefit obligation	452,466	443,562	69,427	82,848
Fair value of plan assets	455,229	390,934	–	–
Funded status as of measurement date	2,763	(52,628)	(69,427)	(82,848)
Employer contribution/other benefits payments after measurement date	207	4,647	586	570
Unrecognized actuarial (gain)/loss	(39,913)	12,842	(11,073)	8,209
Accrued liability recognized in the statement of financial position	**(36,943)**	**(35,139)**	**(79,914)**	**(74,069)**

Registered pension plan assets

As at the measurement date of September 30, the proportion of the fair value of registered pension plan assets held in each asset class was as follows:

	2014	2013
Canadian equity securities	20.6%	20.0%
Foreign equity securities	40.7%	44.0%
Canadian debt securities	37.9%	35.1%
Cash equivalents	1.1%	0.7%
Forward foreign exchange contracts	(0.3%)	0.2%
	100.0%	**100.0%**

Principal assumptions used to calculate benefit obligations at the end of the year are determined at that time and are as follows:

	2014 Pension Benefits	2013 Pension Benefits	2014 Other Benefits	2013 Other Benefits
Discount rate at the end of the period	6.15%	6.25%	6.15%	6.25%
Rate of compensation increase	3.75%	3.75%	3.75%	3.75%
Rate of indexing	2.25%	2.25%	2.25%	2.25%

The assumed prescription drug inflation was 8.50% for 2014 grading down 0.5% per year to 4.75% in 2029. Dental costs are assumed to increase by 4.25% per year.

Benefit costs and plan contributions for pension and other plans are summarized as follows:

(in thousands of Canadian dollars)	2014 Pension Benefits	2013 Pension Benefits	2014 Other Benefits	2013 Other Benefits
	$	$	$	$
Current service cost (employer)	7,707	6,750	2,339	2,053
Interest cost	27,787	26,383	5,241	4,713
Expected return on plan assets	(23,630)	(22,911)	–	–
Amortization of net actuarial loss	1,913	578	586	141
Benefit cost	**13,777**	**10,800**	**8,166**	**6,907**

(in thousands of Canadian dollars)	2014 Pension Benefits	2013 Pension Benefits	2014 Other Benefits	2013 Other Benefits
	$	$	$	$
Employer contribution/other benefit payments	11,973	17,261	2,321	2,093
Plan participants' contributions	3,772	3,476	–	–
Benefits paid	20,862	21,109	2,321	2,093

The most recent actuarial valuation of the registered pension plan for funding purposes was at January 1, 2014, and the date of the next required valuation is January 1, 2015.

Principal assumptions used to calculate benefit costs for the year are determined at the beginning of the period and are as follows:

	2014 Pension Benefits	2013 Pension Benefits	2014 Other Benefits	2013 Other Benefits
Discount rate at the beginning of the period	6.25%	6.50%	6.25%	6.50%
Rate of compensation increase	3.75%	4.00%	3.75%	4.00%
Rate of indexing	2.25%	2.50%	2.25%	2.50%

8. TANGIBLE CAPITAL ASSETS

Net tangible capital assets consist of the following:

Tangible Capital Assets

(in thousands of Canadian dollars)	As at December 31, 2013	Additions	Disposals	As at December 31, 2014
	$	$	$	$
Facilities	50,603	–	(102)	50,501
Market systems and applications	250,098	5,715	(766)	255,047
Infrastructure and other assets	57,409	6,188	(15,465)	48,132
Meter data management/repository	32,608	2,826	–	35,434
Total cost	**390,718**	**14,729**	**(16,333)**	**389,114**

Accumulated Amortization

(in thousands of Canadian dollars)	As at December 31, 2013	Amortization Expense	Disposals	As at December 31, 2014
	$	$	$	$
Facilities	(18,564)	(1,285)	102	(19,747)
Market systems and applications	(224,841)	(10,032)	766	(234,107)
Infrastructure and other assets	(49,886)	(3,656)	15,465	(38,077)
Meter data management/repository	(17,261)	(4,542)	–	(21,803)
Total accumulated amortization	**(310,552)**	**(19,515)**	**16,333**	**(313,734)**

Net Book Value

(in thousands of Canadian dollars)	As at December 31, 2013	As at December 31, 2014
	$	$
Facilities	32,039	30,754
Market systems and applications	25,257	20,940
Infrastructure and other assets	7,523	10,055
Meter data management/repository	15,347	13,631
Total net book value	**80,166**	**75,380**
Assets under construction	11,470	19,671
Net tangible capital assets	**91,636**	**95,051**

In 2014, the impact of adjustments to management's estimates of remaining asset service lives was a decrease in amortization expense of $665 thousand (2013 – $nil thousand).

Interest capitalized to assets under construction during 2014 was $165 thousand (2013 – $44 thousand).

9. OTHER REVENUE

In its administration of the IESO-administered markets, the IESO directs the investment of market funds in highly-rated short-term investments throughout the settlement cycle. The IESO is entitled to receive the investment interest and investment gains, net of investment losses earned on funds passing through the real-time market settlement accounts. The IESO is not entitled to the principal on real-time market investments.

The IESO recognized investment income earned in the market settlement accounts of $1,724 thousand in 2014 (2013 – $1,386 thousand).

The IESO recognizes revenue as it is earned relating to services the IESO performs and charges on a cost recovery basis. Cost recovery revenue in 2014 was $1,834 thousand (2013 – $1,742 thousand).

10. SEGMENT DISCLOSURES

Expenses by object for 2014 are comprised of the following:

(in thousands of Canadian dollars)	Wholesale Market Operations 2014	IESO – OPA Amalgamation 2014	Customer Education and Market Enforcement 2014	Smart Metering Entity 2014	Total 2014
	$	$	$	$	$
Labour	84,573	2,755	2,592	2,909	92,829
Computer services, support and equipment	10,335	–	–	2,706	13,041
Contract services and consultants	6,386	847	1,677	16,169	25,079
Telecommunications	2,951	–	10	27	2,988
Other costs	7,772	1,703	84	198	9,757
Amortization	14,972	–	–	4,543	19,515
Interest expense and financing charges	1,375	–	–	1,317	2,692
Total expenses	**128,364**	**5,305**	**4,363**	**27,869**	**165,901**

Expenses by object for 2013 are comprised of the following:

(in thousands of Canadian dollars)	Wholesale Market Operations 2013	Customer Education and Market Enforcement 2013	Smart Metering Entity 2013	Total 2013
	$	$	$	$
Labour	76,165	2,591	2,634	81,390
Computer services, support and equipment	9,194	–	810	10,004
Contract services and consultants	7,309	1,244	17,650	26,203
Telecommunications	3,237	3	7	3,247
Other costs	7,274	18	33	7,325
Amortization	14,331	–	3,836	18,167
Interest expense and financing charges	912	–	1,561	2,473
Total expenses	**118,422**	**3,856**	**26,531**	**148,809**

11. CAPITAL DISCLOSURES

The IESO's primary objectives are to maintain and enhance the reliability of Ontario's power system, administer the wholesale electricity market, and serve the needs of market participants and stakeholders. In order to fulfill its mandate, the IESO receives fees from market participants (Note 1). The IESO has limited ability to accumulate a surplus from these fees.

The IESO submitted its proposed 2014 expenditures, revenue requirements, and fees to the OEB for review on November 4, 2013 after approval by the Minister. On May 22, 2014 the OEB approved the IESO's proposed expenditures, revenue requirements, and fees for 2014.

The IESO is also the SME and expects to fund its SME operating costs and capital investment in the meter data management/repository through fees from users of smart meters in Ontario. On March 28, 2013 the OEB approved that the Smart Metering Entity charge of $0.788 per month be levied and collected by the Smart Metering Entity from all distributors for each of their residential and general service less than 50 kilowatt customers. This charge is intended to cover the costs of developing and operating the MDM/R to date and until October 31, 2018. The rate was effective May 1, 2013.

12. RELATED PARTY TRANSACTIONS

The Province of Ontario is a related party as it is the controlling entity of the IESO. The OEFC, OPA, OEB, Hydro One and Ontario Power Generation Inc. (OPG) are related parties of the IESO, through the common control of the Province of Ontario. Transactions between these parties and the IESO were as follows:

The IESO holds a note payable and an unsecured credit facility agreement with the OEFC (Note 6). Interest payments made by the IESO in 2014 for the note payable was $1,545 thousand (2013 - $1,511 thousand) and for the credit facility was $671 thousand (2013 – $789 thousand). As of December 31, 2014 the IESO had an accrued interest payable balance with the OEFC of $364 thousand (2013 – $266 thousand).

The IESO provides support to the OPA's Demand Response program. In 2014, the IESO invoiced the OPA $74 thousand (2013 – $137 thousand) for services associated with these programs. As of December 31, 2014 the IESO had a net receivable balance with the OPA of $10 thousand (2013 – net payable balance due to invoice adjustments of $42 thousand).

Under the *Ontario Energy Board Act, 1998*, the IESO incurs registration and licence fees. The total of the transactions with the OEB were $604 thousand in 2014 (2013 – $612 thousand).

The IESO performed connection assessments and approvals for Hydro One in 2014. In 2014, the IESO invoiced Hydro One $437 thousand (2013 – $504 thousand). The IESO procures short circuit studies and protection impact assessments as part of connection assessments and approvals and meter services on IESO owned interconnected revenue meters from Hydro One. In 2014, the IESO incurred costs of $144 thousand (2013 – $522 thousand) for these services. As of December 31, 2014 the IESO had a net receivable balance with Hydro One of $121 thousand (2013 – $296 thousand).

In 2014, the IESO performed connection assessment and approvals for OPG and administered telecommunication services to market participants to connect to the real time market systems. In 2014, OPG was invoiced $54 thousand (2013 – $102 thousand). As of December 31, 2014 the IESO had a net receivable balance with OPG of $4 thousand (2013 – $96 thousand).

13. FINANCIAL RISK MANAGEMENT

The IESO is exposed to financial risks in the normal course of its business operations, including market risks resulting from volatilities in equity, debt, and foreign currency exchange markets, as well as credit risk and liquidity risk. The nature of the financial risks and the IESO's strategy for managing these risks has not changed significantly from the prior year.

a) Market Risk

Market risk refers to the risk that the fair value or future cash flows of a financial instrument will fluctuate to cause changes in market prices. The IESO is exposed to three types of market risk: currency risk, interest rate risk and equity risk. The IESO monitors its exposure to market risk fluctuations and may use financial instruments to manage these risks as it considers appropriate. The IESO does not use derivative instruments for trading or speculative purposes.

i) Currency Risk

The IESO conducts certain transactions in US dollars, primarily related to vendors' payments, and maintains a US dollar denominated bank account. From time to time, the IESO may utilize forward purchase contracts to purchase US dollars for delivery at a specified date in the future at a fixed exchange rate. In addition, the IESO utilizes US dollar spot rate purchases in order to satisfy any current accounts. As at December 31, 2014, the IESO did not have any outstanding forward purchase contracts.

ii) Interest Rate Risk

The IESO is exposed to movements or changes in interest rates primarily through its short-term variable rate credit facility, cash equivalents' securities, and long-term investments. Long-term investments include investments in a pooled Canadian bond fund. The potential impact to the securities' value had the prevailing interest rates changed by 25 basis points, assuming a parallel shift in the yield curve, with all other variables held constant is estimated at $0.5 million as at December 31, 2014 (2013 – $0.4 million).

iii) Equity Risk

The IESO is exposed to changes in equity prices through its long-term investments. Long-term investments include investments in pooled equity funds. A 30% change in the valuation of equities as at December 31, 2014 would have resulted in a change for the year (before the impact of adjustments to the approved regulatory deferral account (Note 5) of approximately $6.0 million (2013 – $6.2 million). The fair values of all financial instruments measured at fair value are derived from quoted prices (unadjusted) in active markets for identical assets.

b) Credit Risk

Credit risk refers to the risk that one party to a financial instrument may cause a financial loss for the other party by failing to meet its obligations under the terms of the financial instrument. The IESO is exposed directly to credit risk related to cash equivalents' securities and accounts receivable, and indirectly through its exposure to the long-term investments in a Canadian bond pooled fund. The IESO manages credit risk associated with cash equivalents' securities through an approved management policy which limits investments to investment grade investments with counterparty-specific limits. The accounts receivable balance as at December 31, 2014 included no material items past due and substantially all of the balance was collected within 30 days from December 31, 2014. The long-term Canadian bond pooled fund is comprised of primarily investment grade securities.

c) Liquidity Risk

Liquidity risk refers to the risk that the IESO will encounter financial difficulty in meeting obligations associated with its financial liabilities when due. The IESO manages liquidity risk by forecasting cash flows to identify cash flows and financing requirements. Cash flows from operations, short-term investments, long-term investments, and maintaining appropriate credit facilities help to reduce liquidity risk. The IESO's long-term investments are normally able to be redeemed within three business days however; the investment manager of the pooled funds has the authority to require a redemption in-kind rather than cash and has the ability to suspend redemptions if deemed necessary.

14. COMMITMENTS AND CONTINGENCIES

Operating commitments

The obligations of the IESO with respect to non-cancellable operating leases over the next five years are as follows:

As at December 31 (thousands of Canadian dollars)

	$
2015	2,290
2016	1,950
2017	1,644
2018	1,074
2019	–

The above figures include lease payments up to July 2017 which have also been included in the 2014 OPA-IESO amalgamation expense ($1,700 thousand).

Contingencies

The IESO is subject to various claims, legal actions, and investigations that arise in the normal course of business. While the final outcome of such matters cannot be predicted with certainty, management believes that the resolution of such claims, actions and investigations will not have a material impact on the IESO's financial position or results of operations.

Executive Compensation at the IESO

Program Objectives

The IESO compensation program for executives was designed to attract, retain and motivate the calibre of executives required to support the achievement of the IESO's statutory mandate, business objectives and corporate vision. Accordingly, the compensation philosophy and programs were built on the following objectives:

- to focus executives on meeting the IESO's business objectives
- to attract qualified and talented staff needed to carry out the IESO's mandate
- to be able to retain valued staff
- to have the flexibility to reward results and demonstrated competencies, and
- to have compensation levels which are responsible and defensible to stakeholders and customers.

The philosophy underlying these objectives is that total compensation for executives should be sufficient, but not overly sufficient, to attract and retain the skills and competencies necessary to carry out the IESO's mandate.

Program Governance

The IESO Board establishes the compensation objectives for the following year's program. They delegate the responsibility to thoroughly review the compensation objectives, policies and programs to the Human Resources and Governance Committee of the Board (HRGC) which make recommendations to the full Board for approval.

The Board is composed of 10 independent, external Directors, appointed by the Minister of Energy, with broad experience in both industry and public sector organizations, plus the President and Chief Executive Officer. Their experience includes many years of dealing with human resource matters including the setting and implementation of compensation policies and programs.

In carrying out their mandate the Board members have access to management's analysis and recommendations as well as those of expert consultants in the compensation field. These programs are reviewed annually with regard to business needs, program objectives and design, industry compensation trends, internal compensation relativities, and external market relativities.

The Board also assesses risks associated with the establishment and implementation of compensation policies and programs. Annually the Board presides over and approves the IESO's Business Plan. An important component of this process is consideration of, and the implementation of mitigating actions, associated with enterprise risk management. This latter overarching process includes the assessment of all significant risks to the IESO, including risks associated with its compensation policies and programs.

In addition to the formal governance and oversight structure in place for compensation matters, the IESO discloses compensation levels annually for staff earning $100,000 or more as part of its public sector salary disclosure. For the IESO, a further level of public review and assurance is provided through a statutorily required annual review of the IESO's expenditures, revenue requirements and fees. For 2014, the IESO's usage fee decreased to $0.803 per megawatt-hour (MWh) from $0.822 per MWh in 2013. The reduction was a result of a change in the method to calculate the fee. Information related to compensation matters, including executive/management compensation and market relativities, is subject to Ontario Energy Board review. A range of small and large consumers, assisted by their legal and professional advisors, are represented in these public proceedings.

Market Comparisons

The IESO reviews the competitiveness of the executive compensation levels in relation to a peer group of Canadian organizations and general industry companies every other year. The objective is to compare IESO executive compensation levels to those in the marketplace particularly in relation to the median of the market.

The IESO undertook a major review of the compensation competitiveness of its executive group in 2014. The peer group consisted of an equal number of private and public sector organizations that meet one or more of the following criteria:

- companies with similar operational and job complexity
- companies operating in the energy services industry (excluding oil & gas organizations) or other regulated industries
- consideration and preference for companies headquartered in Ontario to reflect local talent market.

Given the relationship between executive pay and company size, additional size criteria were applied for the executive peer group, reflecting companies with revenue between $100 million and $5 billion.

The following 28 organizations were used as executive comparators within the analysis:

Public Sector	Private Sector
1. Alberta Electric System Operator	1. ABB Canada
2. Alberta Energy Regulator	2. AltaLink Management
3. British Columbia Hydro and Power Authority	3. ATCO Group
4. Business Development Bank of Canada	4. Bell Aliant Regional Communications
5. Electrical Safety Authority	5. Bruce Power
6. Enmax Corporation	6. Capital Power Corporation
7. EPCOR Utilities	7. FortisAlberta
8. Hydro One	8. NAV Canada
9. Hydro Quebec	9. Siemens
10. Manitoba Hydro Electric	10. SNC-Lavalin Group
11. Ontario Power Authority	11. The Equitable Trust
12. Ontario Power Generation	12. TMX Group Limited
13. SaskPower	13. TransAlta Corporation
14. Toronto Hydro Electric Systems	14. Vancouver International Airport Authority

The job matching was independently conducted by Towers Watson and the following executive positions were covered by this review:

- President & CEO
- VP, Markets, CFO & Treasurer
- VP, Operations & COO
- VP, Corporate & Employee Relations
- VP, Information and Technology Services and CIO
- General Counsel

IESO executive positions were matched to benchmark roles in Towers Watson's general industry executive compensation survey. With respect to the President & CEO and VP Markets, CFO &Treasurer, Towers provided secondary "level" matches in addition to unique benchmark role matches, given the size of companies in the comparator group and the strong correlation between company size and pay for these roles.

Market data was gathered for various components of compensation including fixed compensation and total cash compensation with emphasis on total remuneration, which includes the sum of fixed and variable compensation, benefits and pension.

The results of the review showed that the average total remuneration positioning was around the 25th percentile based on primary benchmarks. Based on secondary benchmarks, the average positioning moved closer towards the median, falling in between the 25th and 50th percentiles.

Program Description

The IESO program includes fixed and variable compensation, core and flex benefit plans, and pension provisions. IESO human resources staff participates in and reviews results from various compensation surveys and monitors economic trends such as gross domestic product trends, inflation and unemployment rates that impact on compensation, as well as monitoring internal compensation relativities. Based on this data and the IESO business priorities, human resources staff develops recommendations on compensation programs. External specialized compensation, benefit and pension consultants are utilized to ensure accurate, representative market compensation data is obtained, that current industry compensation trends are being utilized, as well as to provide insight and recommended adjustments to current programs.

Program Description – Fixed Compensation

Within the IESO broad salary ranges, individuals are assessed as developmental, mature or expert in their position relative to an established competency model. This model consists of behavioural competencies, such as customer focus, drive for results, teamwork, leadership, effective communication and strategic business sense. Assessments are based upon demonstrated competency. Each individual is awarded a fixed compensation level within their band based upon their assessed competency.

Program Description – Variable Compensation

To promote a results orientation in the executive team, the variable pay plan is a significant component of the total compensation of executives. The IESO Board annually establishes a robust set of performance measures that are evaluated each year, and these results carry a 70 percent weight within each executive's variable compensation award. The remaining 30 percent results from the assessment of predetermined measures/targets established for each individual executive.

The IESO Board assesses the corporate performance results and the CEO's individual performance results. Under the plan, having assessed the results against target, the Board has the ability to use some discretion in determining the final performance rating; however, in the past, apart from one occasion, the Board has relied upon the directly assessed results to award variable compensation.

The variable compensation awards for the CEO and Vice-Presidents for achieving the targets are respectively at 65 percent and 50 percent of fixed compensation. The plan provides for awards above or below these target amounts depending on the performance results achieved. To address retention, 50 percent of the earned variable compensation is deferred and paid out over the subsequent two-year period, with accrued but unpaid amounts forfeited in the event of termination with cause or voluntary resignation.

Program Description – Group Benefits

The group benefit plan provides a core level of health and dental benefits, life insurance, disability coverage and vacation, which can be adjusted by individual executives through a flexible component within the plan. The flexible element provides executives the option of adjusting their benefits to meet their individual/family needs including vacation above core amounts, levels of life insurance, health coverage and other components.

Program Description – Pension Plan

A defined benefit pension plan provides annual retirement income calculated as two percent of fixed compensation and one-half percent of variable compensation paid during the highest paid 36 consecutive months of service multiplied by years of service, to a maximum of 35 years. The pension formula is integrated with the Canada Pension Plan (CPP) to provide a level income stream before and after age 65, when the IESO pension is reduced to reflect benefits from CPP. The plan also has early retirement provisions as well as commuted value, pension deferral and reciprocal transfer options.

The plan provides a maximum benefit of 70 percent of highest paid, pre-retirement earnings. As the Canada Revenue Agency limits the amount of pension payable from a registered plan, the IESO has a secured supplemental employee retirement plan (SERP) to provide required pension income to meet the commitments of the plan above that payable from the registered plan.

The plan also provides several options including member's life only or joint and survivor pensions, as well as pre-retirement death benefits to provide benefits to surviving spouses or beneficiaries.

Performance Measures & Impact on Compensation

The IESO annually establishes corporate performance measures relating to its business priorities during the business planning process. These are approved, monitored and assessed by the IESO Board of Directors each year. Individual performance measures supporting one or more corporate performance measures are also developed for each executive.

As outlined above the corporate results achieved each year impact on each executive's variable pay. The following chart highlights each of the business perspectives where performance measures are established and provides a brief description of the performance objectives that were approved by the IESO Board for 2014. For each of these performance objectives specific measures and targets are defined.

Strategic Priorities	Performance Objectives
Deliver Grid Reliability and Market Effectiveness	The IESO-controlled grid provides reliable electricity service today and tomorrow
	The IESO's actions support reliable operation and oversight of the IESO-controlled grid and markets
	The IESO acknowledges and executes action to advance the electricity marketplace
Sector Leadership	Stakeholders have confidence and trust with the IESO's administration of the electricity market
	The IESO is a leader in the electricity sector and able to contribute to important policy decisions
	IESO's technical expertise is acknowledged and respected
Provide For Today and Tomorrow	The IESO's change initiatives meet the needs of customers today and in the future
	The IESO's human resources are capable of meeting the needs of customers today and in the future
	The IESO's financial resources are used effectively and efficiently to meet the needs of customers today and in the future
	The Smart Metering Entity operates the Meter Data Management and Repository (MDM/R) to meet the needs of customers today and tomorrow

A rating scale ranging from partially meeting expectations to exceeding expectations is used to assess the results for both corporate and individual performance objectives as well as to calculate the associated variable pay amount. According to this scale corporate results and individual results may be rated from zero to 1.5 times the target variable amount (the table below outlines the ratings in detail). A payout factor is then determined and applied to the target variable pay amount for each executive.

Performance Rating	Corporate	Individual
Partially meeting expectations	0.0 – 0.7	0.0 – 0.7
Meets expectations	0.8 – 1.2	0.8 – 1.1
Exceeds expectations	1.3 – 1.5	1.2 – 1.5

For 2014 the IESO Board assessed the corporate results as meeting expectations with a rating of 1.05. This was based on the corporate performance on three priorities – deliver grid reliability and market effectiveness, sector leadership and provide for today and tomorrow, each assessed as meeting expectations. In addition to the corporate measures, each executive also had an individual set of measures and targets for the year which aligned with the corporate performance objectives and IESO's business priorities and these were similarly assessed. The Board assessed the results of the CEO's performance and the CEO assessed the performance of the Vice-Presidents, which were also reviewed with the Board.

Other Considerations

Compensation decisions may at times be impacted by market factors – such as the recruitment of an executive with specialized skills/competencies or possessing unique talents within the industry. To this end, individual incumbent arrangements are sometimes established relating to terms of employment and the possibility of future termination.

Effective January 1, 2015, Mr. Campbell was appointed CEO of the new Independent Electricity System Operator as the Ontario government amalgamated the former Ontario Power Authority ("OPA") and the former IESO. His new employment agreement outlines terms and conditions for a 30 month period of employment ending on June 30, 2017, with a potential renewal at least six months prior to the end of the term. Mr. Campbell's employment agreement also provides up to 24 months of severance for termination without cause.

Mr. Thomas was appointed as Vice-President, Information and Technology Services and Chief Information Officer, on March 1, 2014.

Compensation Restraints

The IESO executive compensation has been significantly impacted by the compensation restraint legislation in Ontario since 2010. *The Broader Public Sector Accountability Act (BPSAA)* imposes a general freeze on designated executives' salary, variable pay, benefits and perquisites subject to very limited exceptions.

On December 11, 2014, Bill 8, *Public Sector and MPP Accountability and Transparency Act, 2014* was passed. Bill 8 is designed to control and constrain executive compensation within the broader public sector in Ontario by establishing compensation frameworks that will provide for and limit the elements of compensation and payments that may be provided to designated executives including salaries, salary ranges, benefits, and perquisites, discretionary and non-discretionary payments.

Alignment of the Executive Compensation Plan with the Structure Established for the New CEO

With the appointment on January 1, 2015, of Mr. Campbell as the CEO of the merged organization, the IESO aligned the compensation plan for its Vice-Presidents with the structure established for the new CEO. Accordingly, in both cases, the variable pay component was set at 10 percent. Also, in December, the IESO paid out all outstanding deferred incentive amounts earned in 2014 and prior years with the exception of the President and CEO, whose 2014 earned incentive is scheduled to be paid in 2017.

The figures reported as 2014 remuneration in the 2014 Public Sector Salary Disclosure for the executives will be higher than previous years, as they will include the accelerated payments of all outstanding amounts including the variable pay earned in 2014.

Executive Compensation and Pension Statements

The first table below details the annual compensation for the year ended December 31, 2014, for the executives listed. The information provided in the Summary Compensation Table differs from the information published under the *Public Sector Salary Disclosure Act (Ontario)* for the indicated period due to the timing of payment of variable pay. Disclosures under the *Public Sector Salary Disclosure Act* are limited to amounts listed on T4 taxation forms for each year (i.e., includes variable pay paid out in 2014) whereas information in the summary compensation table is based on the year for which the variable pay was earned.

The **second table** below outlines pension plan participation and benefits for each of the Executive Officers listed. Specifically detailed are:

- total years of credited service in the pension plan
- the increase in the compensatory value of the pension (due to increased service and pensionable earnings, if applicable) during 2014
- the increase in the non-compensatory value of pension (due to a decrease in the pension discount rate) during 2014
- the estimated annual pension payable at age 65 based upon the executive's service and pensionable earnings as of December 31, 2014
- the estimated annual pension with service credits projected to age 65 using actual pensionable earnings as of December 31, 2014.

Various factors have an impact on the pension calculations displayed in Table 2. Should interest or discount rates vary significantly from one year to the next, there will be volatility in year-over-year pension amounts reported.

Use of Consultants

During 2014 the services of Aon Hewitt were used for the development of pension data and updates on disclosure requirement. Aon Hewitt also provided pension and benefit actuarial support to the IESO during 2014 as well as pension and benefit consulting services. These services were obtained through competitive bidding processes.

2014 Summary Compensation Table

Name & Position	Salary	Variable Pay	Other Annual Compensation[1]	Total Cash Compensation	Amounts Reported Under Public Sector Salary Disclosure[2]
Bruce Campbell President & CEO	$345,000	$248,918[3]	$ 7,524	$601,442	$694,468
Ted Leonard VP Markets, CFO & Treasurer	$209,062	$111,326	$14,612	$335,000	$518,566
Kim Warren VP Operations & COO	$228,094	$123,855	$11,071	$363,020	$577,000
Terry Young VP Corporate & Employee Relations	$219,384	$119,125	$17,439	$355,948	$552,729
Doug Thomas[4] VP Information & Technology Services & CIO	$219,170	$105,037	$ 3,918	$328,125	$419,040

1. Represents remaining flex credits paid out at year end as taxable income.
2. Represents higher than usual earnings due to the payment in December 2014 of the variable pay earned in 2014 in addition to the payment of all outstanding deferred variable compensation amount earned in prior years.
3. 2014 earned variable compensation to be paid in 2017.
4. Appointed to Vice President, Information & Technology Services & CIO on March 1, 2014.

2014 Pension Benefits Table

Name & Position	Number of Years Credited Service	Increased Pension Value During 2014		Annual Benefits Payable Upon Retirement	
		Compensatory Amount During Year	Non Compensatory Amount During Year	At Year End (2014)[1]	At Age 65[2]
		$	$	$	$
Bruce Campbell[3] President & CEO	28.417	$214,000	$381,000	$214,000	$214,000[4]
Ted Leonard VP Markets, CFO & Treasurer	18.750	$ (54,000)	$106,000	$ 86,000	$161,000
Kim Warren VP Operations & COO	35.000	$ 84,000	$ 76,000	$179,000	$179,000
Terry Young VP Corporate & Employee Relations	31.667	$ 10,000	$ 50,000	$155,000	$171,000
Doug Thomas VP Information & Technology Services & CIO	16.250	$176,000	$ 99,000	$ 71,000	$106,000

1. Payable at age 65 assuming no increase in pensionable earnings & service beyond year-end 2014.
2. Payable at age 65 assuming no increase in pensionable earnings beyond year-end 2014 and credited service continues until age 65.
3. Mr. Campbell was promoted to CEO on May 1, 2013.
4. Mr. Campbell's accrued pension payable at the valuation date is shown, as he is over age 65.

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